the price of the stock over that period. The 30-day contracts discussed above are not comparable to such 12-month options, because instances of true expectations of price changes of this magnitude over a 30-day period would be exceedingly rare. And a contract that does not reflect such true expectations of price change, plus a reasonable fee for the services of the writer, is not an option in the accepted meaning of the term.

(h) Because of the virtual certainty that the contract right would be exercised under the proposal described above, the writer would buy the stock in a margin account with an indorsing firm immediately on writing the contract. The indorsing firm would extend credit in the amount of 20 percent of the current market price of the stock, the maximum permitted by the current §220.8 (supplement to Regulation T). The writer would deposit the 30 percent supplied by the buyer, and furnish the remaining 50 percent out of his own working capital. His account with the indorsing firm would thus be appropriately margined.

(i) As to the buyer, however, the writer would function as a broker. In effect, he would purchase the stock for the account, or use, of the buyer, on what might be described as a deferred payment arrangement. Like an ordinary broker, the writer of the contract described above would put up funds to pay for the difference between the price of securities the customer wished to purchase and the customer's own contribution. His only risk would be that the price of the securities would decline in excess of the customer's contribution. True, he would be locked in, and could not liquidate the customer's collateral for 30 days even if the market price should fall in excess of 30 percent, but the risk of such a decline is extremely slight.

(j) Like any other broker who extends credit in a margin account, the writer who was in the business of writing and selling such a contract would be satisfied with a fixed predetermined amount of return on his venture, since he would realize only the fee charged. Unlike a writer of ordinary puts and calls, he would not receive a substantial part of his income from fees on unexercised contract rights. The similarity of his activities to those of a broker, and the dissimilarity to a writer of ordinary options, would be underscored by the fact that his fee would be a fixed predetermined amount of return similar to an interest charge, rather than a fee arrived at individually for each transaction according to the volatility of the stock and other individual considerations.

(k) The buyer's general account with the writer would in effect reflect a debit for the purchase price of the stock and, on the credit side, a deposit of cash in the amount of 30 percent of that price, plus an extension of credit for the remaining 70 percent, rather than the maximum permissible 20 percent.

(l) For the reasons stated above, the Board concluded that the proposed contracts would involve extensions of credit by the writer as broker in an amount exceeding that permitted by the current supplement to Regulation T. Accordingly, the writing of such contracts by a brokerage firm is presently prohibited by such regulation, and any brokerage firm that endorses such a contract would be arranging for credit in an amount greater than the firm itself could extend, a practice that is prohibited by §220.7(a).

[35 FR 3280, Feb. 21, 1970]

§220.123 Partial delayed issue contracts covering nonconvertible bonds.

(a) During recent years, it has become customary for portions of new issues of nonconvertible bonds and preferred stocks to be sold subject to partial delayed issue contracts, which have customarily been referred to in the industry as ''delayed delivery'' contracts, and the Board of Governors has been asked for its views as to whether such transactions involve any violations of the Board's margin regulations.

(b) The practice of issuing a portion of a debt (or equivalent) security issue at a date subsequent to the main underwriting has arisen where market conditions made it difficult or impossible, in a number of instances, to place an entire issue simultaneously. In instances of this kind, institutional investors (e.g., insurance companies or pension funds) whose cash flow is such that they expect to have funds available some months in the future, have been willing to subscribe to a portion, to be issued to them at a future date. The issuer has been willing to agree to issue the securities in two or more stages because it did not immediately need the proceeds to be realized from the deferred portion, because it could not raise funds on better terms, or because it preferred to have a certain portion of the issue taken down by an investor of this type.

(c) In the case of such a delayed issue contract, the underwriter is authorized to solicit from institutional customers offers to purchase from the issuer, pursuant to contracts of the kind described above, and the agreement becomes binding at the underwriters' closing, subject to specified conditions. When securities are issued pursuant to the agreement, the purchase price includes accrued interest or dividends, and until they are issued to it, the purchaser does not, in the case of bonds, have rights under the trust indenture, or, in the case of preferred stocks, voting rights.

(d) Securities sold pursuant to such arrangements are high quality debt issues (or their equivalent). The purchasers buy with a view to investment and do not resell or otherwise dispose of the contract prior to its completion. Delayed issue arrangements are not acceptable to issuers unless a substantial portion of an issue, not less than 10 percent, is involved.

(e) Sections 3(a) (13) and (14) of the Securities Exchange Act of 1934 provide that an agreement to purchase is equivalent to a purchase, and an agreement to sell to a sale. The Board has hitherto expressed the view that credit is extended at the time when there is a firm agreement to extend such credit (1968 Federal Reserve Bulletin 328; 12 CFR 207.101; ¶ 6800 Published Interpretations of the Board of Governors). Accordingly, in instances of the kind described above, the issuer may be regarded as extending credit to the institutional purchaser at the time of the underwriters' closing, when the obligations of both become fixed.

(f) Section 220.7(a) of the Board's Regulation T (12 CFR 220.7(a)), with an exception not applicable here, forbids a creditor subject to that regulation to arrange for credit on terms on which the creditor could not itself extend the credit. Sections 220.4(c) (1) and (2) (12 CFR 220.4(c) (1) and (2)) provide that a creditor may not sell securities to a customer except in good faith reliance upon an agreement that the customer will promptly, and in no event in more than 7 full business days, make full cash payment for the securities. Since the underwriters in question are creditors subject to the regulation, unless some specific exception applies, they are forbidden to arrange for the credit described above. This result follows because payment is not made until more than 7 full business days have passed from the time the credit is extended.

(g) However, § 220.4(c)(3) provides that:

> If the security when so purchased is an unissued security, the period applicable to the transaction under subparagraph (2) of this paragraph shall be 7 days after the date on which the security is made available by the issuer for delivery to purchasers.

(h) In interpreting § 220.4(c)(3), the Board has stated that the purpose of the provision:

> * * * is to recognize the fact that, when an issue of securities is to be issued at some future fixed date, a security that is part of such issue can be purchased on a ''when-issued'' basis and that payment may reasonably be delayed until after such date of issue, subject to other basic conditions for transactions in a special cash account. (1962 Federal Reserve Bulletin 1427; 12 CFR 220.118; ¶5996, Published Interpretations of the Board of Governors.)

In that situation, the Board distinguished the case of mutual fund shares, which technically are not issued until the certificate can be delivered by the transfer agent. The Board held that mutual fund shares must be regarded as issued at the time of purchase because they are:

> * * * essentially available upon purchase to the same extent as outstanding securities. The mechanics of their issuance and of the delivery of certificates are not significantly different from the mechanics of transfer and

delivery of certificates for shares of outstanding securities, and the issuance of mutual fund shares is not a future event in the sense that would warrant the extension of the time for payment beyond that afforded in the case of outstanding securities. (ibid.)

The issuance of debt securities subject to delayed issue contracts, by contrast with that of mutual fund shares, which are in a status of continual underwriting, is a specific single event taking place at a future date fixed by the issuer with a view to its need for funds and the availability of those funds under current market conditions.

(i) For the reasons stated above the Board concluded that the nonconvertible debt and preferred stock subject to delayed issue contracts of the kind described above should not be regarded as having been issued until delivered, pursuant to the agreement, to the institutional purchaser. This interpretation does not apply, of course, to fact situations different from that described in this section.

[36 FR 2777, Feb. 10, 1971]

§ 220.124 Installment sale of tax-shelter programs as "arranging" for credit.

(a) The Board has been asked whether the sale by brokers and dealers of tax-shelter programs containing a provision that payment for the program may be made in installments would constitute ''arranging'' for credit in violation of this part 220. For the purposes of this interpretation, the term ''tax-shelter program'' means a program which is required to be registered pursuant to section 5 of the Securities Act of 1933 (15 U.S.C. section 77e), in which tax benefits, such as the ability to deduct substantial amounts of depreciation or oil exploration expenses, are made available to a person investing in the program. The programs may take various legal forms and can relate to a variety of industries including, but not limited to, oil and gas exploration programs, real estate syndications (except real estate investment trusts), citrus grove developments and cattle programs.

(b) The most common type of tax-shelter program takes the form of a limited partnership. In the case of the programs under consideration, the investor would commit himself to purchase and the partnership would commit itself to sell the interests. The investor would be entitled to the benefits, and become subject to the risks of ownership at the time the contract is made, although the full purchase price is not then required to be paid. The balance of the purchase price after the downpayment usually is payable in installments which range from 1 to 10 years depending on the program. Thus, the partnership would be extending credit to the purchaser until the time when the latter's contractual obligation has been fulfilled and the final payment made.

(c) With an exception not applicable here, § 220.7(a) of Regulation T provides that:

A creditor [broker or dealer] may arrange for the extension or maintenance of credit to or for any customer of such creditor by any person upon the same terms and conditions as those upon which the creditor, under the provisions of this part, may himself extend or maintain such credit to such customer, but only such terms and conditions * * *

(d) In the case of credit for the purpose of purchasing or carrying securities (purpose credit), § 220.8 of the regulation (the Supplement to Regulation T) does not permit any loan value to be given securities that are not registered on a national securities exchange, included on the Board's OTC Margin List, or exempted by statute from the regulation.

(e) The courts have consistently held investment programs such as those described above to be ''securities'' for purpose of both the Securities Act of 1933 and the Securities Exchange Act of 1934. The courts have also held that the two statutes are to be construed together. Tax-shelter programs, accordingly, are securities for purposes of Regulation T. They also are not registered on a national securities exchange, included on the Board's OTC Margin List, or exempted by statute from the regulation.

(f) Accordingly, the Board concludes that the sale by a broker/dealer of tax-shelter programs containing a provision that payment for the program may be made in installments would